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RUEHOT/AMEMBASSY OTTAWA 0772
RUEHFR/AMEMBASSY PARIS 1546
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TAGS: EMIN ENRG EINV ETRD EPET KHIV ZI SF
SUBJECT: SOUTH AFRICAN MINING EXECUTIVES DISCUSS GLOBAL AND
DOMESTIC CHALLENGES

REF: 08 PRETORIA 2732

¶1. (SBU) SUMMARY: A group of South African mining executives expressed concern about the effects of the global commodity downturn on the mining sector and associated social transformation in South Africa. They highlighted a number of challenges of doing mining business in South Africa, many directly related to the heavy hand of the state on the sector and key services like power, transport, telecom, and health. They saw signs of an upturn in Chinese demand for iron ore as a glimmer of hope. They cited the mining sector as a leader for black economic empowerment and combating HIV/AIDS, where workforce prevalence rates have flattened. A platinum executive with interests in Zimbabwe expressed pessimism about the unity government there. End Summary.

¶2. (U) Charge hosted four South African mining executives for a lunch at her residence on March 5 for a tour d'horizon on the troubled mining sector. Attendees were:

Charge Helen La Lime
Economic Counselor Perry Ball
Commercial Counselor Craig Allen
Minerals/Energy Officer David Young (note-taker)

Chamber of Mines Economist Roger Baxter
Consultant Con Fauconnier (former Kumba Resources CEO)
Aquarius Platinum CEO Stuart Murray
Anglo American Manager: Engineering Keith Prakke

Importance of Mining

¶3. (SBU) Chamber of Mines Economist Roger Baxter provided his analysis on the importance of mining to the South African economy. According to Baxter, mining:

-- Contributes directly 6-8 percent of GDP.
-- Contributes indirectly/induced 17-18 percent of GDP.
-- Represents an even greater percentage of GDP in Northwest,

Mpumalanga, Limpopo, and Free State Provinces.
-- Provides over 500,000 direct jobs and another 500,000 indirect jobs.
-- Supports extended families of 10 million people.
-- Supports the domestic economy. Of R310 billion ($30 billion) in mining revenues, R302 billion are captured locally through procurement, wages, capital expenditures, taxes, dividends, and bank interest. Only a portion of dividends depart the country to pay back foreign investors.
-- Expands initial investment with a multiplier effect of 2.5 times.

Global Markets - How Bad Will It Get?

¶4. (SBU) The consensus of the group was that the global commodity slowdown was generating dire effects on the South African economy. Baxter said 30,000 mining jobs were at risk, but also pointed out that the industry had created 60,000 over the last two years. He noted that retrenchment in South Africa was not easy, requiring three months of consultation and justification with a variety of government and union entities. Fauconnier said 17 of 20 ferrochrome furnaces at Merafe Resources had been closed because of global over-stocking, but he said the company was still trying to keep its skilled labor force. The miners perceived
Qtrying to keep its skilled labor force. The miners perceived
a welcome up-tick in iron demand, notably from China, an early indicator of a potential turn-around in the global steel market. Former Kumba Resources (iron) CEO Con Fauconnier said iron ore sales were increasing from South

Africa's major mine, Sishen in the Northern Cape (Reftel). The guests agreed that China's growth would not likely sink below 8 percent, because of sustained domestic demand from rapid urbanization and government spending on infrastructure. They believed that the global commodity market "will turn -- and when it turns, it will turn fast," because of the depletion of stocks and new projects. Fauconnier said China will purchase 80 percent of sea-borne traded iron by 2025.

Intervention by the State

¶5. (SBU) The mining guests were critical of the heavy hand of the state imposed on the domestic economy, particularly by the monopoly or dominant position of state power utility Eskom, state rail company Transnet Freight, and state controlled telecommunications company Telkom. Baxter said the associated regulatory, infrastructure, power, and telecom constraints blocked South Africa from sustaining its growth potential of 4 percent. Baxter noted that there had been some 3,000 changes to mining legislation and 4,000 changes to mining regulation since the ANC government took power. He asserted that a new Zuma-led ANC government would not bring dramatic economic policy changes, but that there is a wide perception that the government has failed in service delivery to its citizens. Baxter said privatization would have a pejorative meaning to the ANC struggle veterans, but the granting of private concessions would be a practical way to unblock constraints on growth.

Power Challenges

¶6. (SBU) Power supply uncertainty has been a worry in the mining sector in South Africa and the region since the South African power crisis temporarily shut down mines in January
¶2008. State power utility Eskom has gained a respite from the global slowdown and resulting furnace closures, but South Africa's reserve margin remains only eight percent (versus an acceptable target of 15-20 percent). Baxter said there were

duplicative and redundant crisis task teams meeting last year, but he saw the government finally asserting greater clarity this year with the National Emergency Response team, representing diverse stakeholders. Baxter and Fauconnier said financing for Eskom's R350 billion ($33 billion) five-year capital expenditure program for new supply was daunting. The government has pledged direct equity support of R60 billion ($6 billion) and guarantees of R170 billion ($17 billion), leaving a significant gap. The group was frustrated that the government has been unable to create a transparent and attractive regulatory environment for gaining private investment in power. Eskom's dominant position and artificially low pricing were persistent obstacles.

¶7. (SBU) Fauconnier was disappointed about the government's recent postponement of the Eskom nuclear power contract, but he saw eventual establishment of new nuclear power plants as Qhe saw eventual establishment of new nuclear power plants as a greater share in the energy mix as inevitable. He said South Africa's next two mega-power stations (Medupi in Limpopo Province and Kusile in Mpumalanga Province - each almost 5,000 MW) were coal stations under construction. The third would likely also be coal, but he predicted the fourth or fifth would have to be nuclear, alternating with another mega-coal facility. Fauconnier said Medupi's cost had ballooned from R55 billion to over R100 billion from escalating input costs. The mining executives were surprised at the Minister of Energy's recent announcement that the electricity distribution system was in crisis and required R27 billion ($2.5 billion) in deferred capital investment to keep it in working order.

Transport Challenges

¶8. (SBU) State railroad company Transnet Freight was a general target of frustration of the mining executives, because of the rail firm's uncertain and inefficient service delivery. Baxter said Transnet's cost for shipping steel from the port of Durban to Johannesburg was greater than the cost of shipping steel from Shanghai to Durban. He said 80 percent of containers from Durban to Johannesburg were now shipped twelve hours by road, versus three weeks and the uncertainty of potential loss by rail. Fauconnier said Kumba had made an offer for a private concession to fund expansion of the iron ore line from Sishen to Saldanha port, but Transnet refused. A comparable private offer for augmenting coal transport to Richards Bay port has also been refused by Transnet. Fauconnier said Transnet and the government appeared philosophically opposed to such a private undertaking and they were loath to lose or share the Sishen and Richards Bay rail lines, as they are the most lucrative of the six rail lines that lead to the major ports from the mineral-rich interior.

Telecom Challenges

¶9. (SBU) The mining interlocutors voiced similar frustration with Telkom, the state-controlled, dominant telecommunications company. South African consumers face high prices, even in mobile communication, where there is growing competition. Murray noted that South African mobile service is expensive, but the service and coverage is excellent, compared to even developed countries like the U.S. and the U.K.

Transformation Challenges - BEE and Education

¶10. (SBU) Mining managers accept Black Economic Empowerment

(BEE) as a part of necessary social transformation to redress past injustices and see BEE as a reasonable cost of doing business in South Africa. Under the mining charter, BEE equity must total 14 percent of total equity this year and 26 percent by 2014. Baxter said mining has provided leadership and the largest industry role in implementing BEE deals. He said mining BEE deals total R150 billion ($14.5 billion) or 35 percent of total BEE deals. Fauconnier said he worked with one of the first big BEE deals wherein BEE firm Exxaro was created at a 3 percent cost to share-holders. He noted the problem is that only a few black South Africans have benefited from BEE provisions. Fauconnier said the current downturn was negatively impacting BEE deals, but mining companies were committed to making sure the deals remained viable. The mining executives recognized that there was a risk that the government could increase the BEE requirements, but they said there was a practical limit for sustaining business. Fauconnier expressed concern that a future ANC government could raise the 26 percent requirement. He hoped Qgovernment could raise the 26 percent requirement. He hoped that BEE could reach a self-sustaining basis, where all equity holders could practice normal business practices and share trading. Prakke said an equally vexing challenge for South Africa is education, where performance was abysmal, notwithstanding education claiming a relatively high 6-7 percent of GDP. He said it was difficult for black university students to study engineering if they had failed or not been offered high school math and science courses. One solution would be to extend university studies by one year to provide remedial instruction in these areas.

HIV/AIDS Challenges

¶11. (SBU) The group was optimistic that the government role in health would continue to improve under new Minister of Health Barbara Hogan. They pointed out that the mining sector has played a leadership role in addressing HIV/AIDS in its workforce since 1986. Fauconnier said overall HIV prevalence in the workforce was 22-25 percent. This is much lower than the commonly held belief that the rate is 35 percent. The good news is that the rate is now flat, they said, rather than increasing. Baxter said there would be some variance between sectors, with gold higher because of its traditionally greater reliance on migrant foreign workers from neighboring SADC countries. They said mining companies were gaining greater compliance on voluntary consultation testing programs. Mining companies are also providing comprehensive treatment to families and communities, not just workers. Baxter said the economics of "doing something, rather than doing nothing" on HIV/AIDS were compelling for mining companies. This is why a lot of efforts are being taken to both treat HIV/AIDS and to prevent new infections.

Doubts about Zimbabwe's New Government

¶12. (SBU) Aquarius Platinum Stuart Murray told Energy Officer after the lunch that he lacked any confidence in the unity government in Zimbabwe. His company has significant platinum interests there. He believed that until President Mugabe was really gone, the donor countries should maintain a hard position. Murray thought it was not the right time to respond to Prime Minister Tsvangarai's appeal for funds. He said ironically the dollarization of the economy was hurting his company. Whereas there was no longer any forced conversion of some revenues into Zimbabwe dollars, the company now had to pay import duties in U.S. dollars, rather than Zimbabwe dollars. Murray feared that there would be a resulting margin squeeze on platinum companies operating in Zimbabwe.

¶13. (SBU) Comment: The participants discussed the fact that many South African executives are forced to spend much of their time on power, transport, transformation, and health, rather than on traditional challenges such as mining, processing, and marketing minerals and finished products, which would be the primary focus of executives in Australia and Canada, for example. He then noted that there seemed to be a relatively high rate of turnover for South African mining executives, perhaps because of burn-out. Fauconnier agreed and said because of South Africa's complex set of circumstances, South African managers gain responsibility and complex skills at a young age and tend to be successful in Australia and other countries. He said that six years was a good target for the useful term of a South African mining CEO (regretting that he hung on for eight years). The mining
Q(regretting that he hung on for eight years). The mining
executives were cautiously optimistic about the global market and South Africa's relative position in the global industry, but feared the possibility of greater government intervention on the part of future governments.

LA LIME